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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS, JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; and MORTGAGE TRUST OF AMERICA,

Petitioners,

vs.

HARRY LEWIS,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

Motion for Leave to File Brief Amicus Curiae and Brief Amicus Curiae in Support of Respondent

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January 31, 1979

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Mary Sullivan, William Shapiro, Fanne Shapiro and Kenneth Batchelor hereby respectfully move for leave to file the attached brief as *amici curiae* in this case. The consent of the attorneys for respondent has been obtained. The consent of attorneys for petitioner Transamerica Mortgage Advisors, Inc. ("TAMA") was requested but refused. The attorneys for the other petitioners indicated that they

would consent to the filing of the brief of the instant *amici* only if counsel for TAMA would so consent.

The interests of Mary Sullivan, William Shapiro, Fanne Shapiro and Kenneth Batchelor in this case arise from the fact that they are the representative plaintiffs in a class action presently pending in the United States District Court for the Northern District of California in which the question whether a private right of action may be implied under the Investment Advisers Act of 1940 (Advisers Act) was answered affirmatively by the trial court. *Sullivan et al. v. Chase Investment Services of Boston, Inc., et al.*, 434 F.Supp. 171 (N.D.Cal. 1977). *See also Sullivan et al. v. Chase Investment Services of Boston, Inc., et al.*, 79 F.R.D. 246 (N.D.Cal. 1978) (class action certified).

These moving parties believe that their interests in *Sullivan* will not adequately be represented by the respondent herein because of substantial differences between the facts alleged to give rise to claims of private civil remedies under the Advisers Act in *Sullivan* as opposed to the instant case. Moreover, the moving parties believe it should be emphasized that their right to sue for damages on the facts alleged in *Sullivan* is consistent with Judge Gurfein's concurring and dissenting opinion in *Abrahamson v. Fleschner*, 568 F.2d 862, 879, 882 n.8 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978) which opinion the petitioners in the instant case have embraced. (Petition for Writ of Certiorari at 5.)

The defendant adviser in the instant case has had only one client, never advertised its services or solicited clients, and never held itself out to the public as an investment adviser. (Brief for Petitioners at 3-4).

In contrast, *Sullivan* involves allegations that an investment adviser induced a nationwide class of more than one

thousand investors by means of fraudulent promotional literature to place under its discretionary investment advisory management portfolios consisting of cash and securities.

For the foregoing reasons, it is believed that the brief which *amici curiae* are requesting permission to file contains a more complete argument on the question whether *fraudulent inducement* to enter into an investment advisory relationship with an investment adviser gives rise to private damage remedies under the Investment Advisers Act of 1940, than will the brief to be filed by respondents herein.

Respectfully submitted,

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Brief for Amici Curiae in Support of Respondent

STATEMENT OF INTEREST OF AMICI CURIAE

The instant *amici curiae* are the representative plaintiffs in a major securities fraud class action which has been pending before the United States District Court for the Northern District of California since August, 1976. *See Sullivan et al. v. Chase Investment Services of Boston, Inc., et. al.,* 79 F.R.D. 246 (N.D. Cal 1978) (class action certified). The trial court has ruled in *Sullivan* that the class may

recover damages upon proof of violation of § 206 of the Investment Advisers Act of 1940 (Advisers Act). *Sullivan et al. v. Chase Investment Services of Boston, Inc. et al.*, 434 F.Supp. 171 (N.D.Cal. 1977).[1] The *Sullivan* action is, to the knowledge of *amici*, the first and, at this date, the only action asserting claims under the Advisers Act to be certified as a class action by any court.

Sullivan involves the assertion of claims that an investment adviser, Chase Investment Services of Boston, Inc. ("CIS") fraudulently induced a class of more than 1000 investors, who were members of the general public, to place under its discretionary investment advisory management portfolios consisting of cash and securities whose values ranged from $25,000 to $500,000 each.[2] During the period of CIS management these portfolios declined in value by approximately $18 million.[3]

1. In so ruling, the district court held that the *Sullivan* plaintiffs' allegations of fraud in connection with the sale of investment advisory services, while stating a claim for relief under the Advisers Act, *did not* state a claim for relief under § 10b of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b). 434 F.Supp. at 175-77.

2. The defendant advisers in *Sullivan*, CIS and its parent company, John P. Chase, Inc. ("JPC") have determined that the opening value of portfolios placed under CIS management during the period in question in *Sullivan* averaged approximately $55,000. Evidentiary Summary Submitted by CIS and JPC in Opposition to Plaintiffs' Motion for Class Certification, § 2.3. As the district court noted, even the defendants' figures show that the size of the *Sullivan* class numbers approximately 1000. 79 F.R.D. at 257. Thus the aggregate value of the portfolios affected by the fraud alleged in *Sullivan* is approximately $55 million, at a minimum.

3. The defendant advisers in *Sullivan* calculated the average decline in portfolio value under CIS management. From a random sample of 100 accounts, these defendants found that 90 percent of the accounts opened during the class period declined in value; the loss in value of such accounts averaged almost $20,000. Evidentiary Summary, *supra*, note 2, at § 2.8. Taking the district court's figure of 1000 account-holders for the minimum size of the class and the defendant advisers' data that 90 percent of the account-holders suffered loss under CIS management, the total loss to class members approximates $18 million.

The fraudulent inducement in *Sullivan* consisted of the publication and nationwide dissemination of two "performance charts" which *amici* allege—and which the Securities and Exchange Commission ("SEC") has already found (see Addendum to this brief)—to have grossly exaggerated the past performance of the investment adviser.[4] The fraudulent charts were distributed directly by CIS to members of the public who made inquiries stimulated by advertising or referrals by broker-dealers. The charts were also distributed by CIS to broker-dealers for redistribution to the brokers' clients. CIS, for an advisory fee, managed the customers' portfolios on a discretionary basis. All trades ordered by CIS were executed by the customers' personal broker-dealers, who thereby collected their standard commissions on all trades in CIS-managed accounts.

E.F. Hutton & Co., Inc., Dean Witter & Co., Inc., and Mitchum, Jones & Templeton, the broker dealers who dealt with the named plaintiffs, are also defendants in *Sullivan*. The brokers' liability is premised upon their having acted with scienter in aiding and abetting CIS in the distribution of the fraudulent charts. The district court has certified subclasses of all class members who dealt with these brokers.

Another defendant in *Sullivan* is the Boston law firm of Sullivan & Worcester, which is alleged to have acted with

4. The two charts purported to compare very excellent CIS performance over designated time intervals with the performance of the Dow Jones Industrial and Composite Averages and the Standard and Poor's 425 Average. The charts gave the impression of depicting the performance of all the growth accounts managed by CIS during the period of time designated. However, the charts actually depicted the results of only five particularly successful accounts out of the many hundreds of accounts managed during the periods purportedly covered by the charts—periods in which the results achieved by most of the CIS growth-oriented accounts were far less favorable than the performance of the five accounts depicted in the charts.

scienter in aiding and abetting CIS by participating in the drafting of the fraudulent promotional material (including the charts) which was disseminated by CIS.

The *Sullivan* class litigation was commenced after the Securities and Exchange Commission issued its Findings and Order Imposing Remedial Sanctions in a proceeding involving CIS, its parent corporation (JPC) and certain CIS officers. The Findings and Order is included in the Addendum to this brief.

The Commission concluded that CIS and two of its officers had "willfully violated and willfully aided and abetted each others' willful violations of the antifraud provisions of the Investment Advisers and Securities Exchange Acts." Addendum at 7 (footnote omitted).

Although the respondents in the SEC proceedings consented to the Order imposing sanctions, the Commission neither sought nor obtained the reimbursement of portfolio losses, commissions or advisory fees for the victims of the CIS fraud. CIS has estimated that advisory fees paid by class members to CIS total approximately $2 million. *Sullivan, supra,* 79 F.R.D. at 263 n.9.

SUMMARY OF ARGUMENT

To the extent determinable from the embryonic record, wholly unsuited to review by this Court, the case at bar involves facts which do not present the type of fraudulent conduct which the Investment Advisers Act was expressly established to prevent. The lack of face-to-face dealings between the adviser and the plaintiff, the lack of direct damage to the person being advised, and the lack of fraudulent inducement to enter into the investment adviser relationship combine to suggest that the writ of *certiorari* should be dismissed as improvidently granted. Indeed, if

petitioners' contentions before the district court and the Ninth Circuit are correct, the issue of private remedies for Advisers Act violations is a *moot* point in this case.

Should the Court reach the merits of the case, the Court should apply the four-pronged test of *Cort v. Ash,* 422 U.S. 66 (1975) to determine the existence of an implied right of action for damages under the Advisers Act. Three of these prongs point directly to implying a private right of action for violation of § 206 of the Advisers Act. The other prong, while less indicative, at least leans in the same direction.

(1) The Advisers Act was unmistakeably enacted especially to benefit clients and prospective clients by protecting them from dishonest and self-dealing advisers. *Securities and Exchange Commission v. Capital Gains Research Bureau,* 375 U.S. 180, 191 (1963), *Abrahamson v. Fleschner,* 568 F.2d 862, 873 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978), *Sullivan v. Chase Investment Services of Boston, Inc.,* 434 F.Supp. 171, 180 (N.D.Cal. 1977).

(2) An implied right of action by clients and prospective clients is not only consistent with the Advisers Act but is necessary to effectuate its underlying purposes in view of the many thousands of advisers subject to the Act's provisions and the limited resources of the Securities and Exchange Commission to monitor those activities and to enforce the Act's mandates.

(3) The regulation of investment advisers is not one traditionally relegated to state law, nor have the states, to any meaningful extent, provided for damage remedies against advisers who defraud their clients. *Sullivan, supra,* at 184. The Advisers Act established federal fiduciary standards for investment advisers, *Santa Fe Industries, Inc. v. Green,* 430 U.S. 462, 471 n.11 (1977), which will

go largely unenforced unless private litigants are afforded federally created, compensatory remedies as an adjunct to SEC disciplinary proceedings. As a practical matter, the only effective way to take the profit out of advisory fraud which is perpetrated on a nationwide scale is to provide injured advisory clients with the federal remedies, substantive and procedural, which will allow nationwide federal relief free of the vagaries of state law and the ruinous costs of litigating separate actions on behalf of each states' class of injured clients.

(4) Although the Advisers Act contains an unmistakeable indication that Congress intended private individuals to have some form of relief under the Act, there is very little evidence either to create or deny private damage remedies for Advisers Act violations. *Abrahamson, supra,* at 875; *Sullivan, supra,* at 182.

In sum, the circumstances of the claims of *amici* against their adviser demonstrate that an outright rejection of implied rights of action under the Advisers Act, in any and all circumstances, would be antithetical to the manifest intent of Congress in enacting the Advisers Act. This Court should either dismiss its writ of *certiorari* as improvidently granted, or define the circumstances in which a private right of action for damages under the Advisers Act is to be implied, and remand the instant case for further consideration whether such criteria are met.

ARGUMENT

Amici believe that their claims against a fraudulent investment adviser are substantially different from those at issue in the case at bar and may, accordingly, alert the Court to certain matters presented in *Sullivan,* but not in the case at bar, which may be of controlling significance in

the determination whether a private right of action exists by implication under the Advisers Act. For the reasons to be stated below, *amici* urge this Court either to conclude that the instant writ of *certiorari* should be dismissed as improvidently granted, or, in the event the case is to be heard on the merits, to hold that there is—under certain factual conditions at least—an implied right of action for damages under § 206 of the Advisers Act.

A. The Writ of Certiorari Was Improvidently Granted and Should Be Dismissed.

The case at bar is substantially different from the facts of *Sullivan.* The respondent's complaint does not charge the investment adviser with having fraudulently induced members of the public to place portfolios under its discretionary management. Rather, it alleges that the shareholders in a real estate investment trust were indirectly harmed because of improper administration of the affairs of the investment trust by controlling and affiliated persons and entities. This conduct is claimed to have resulted in an unfair investment advisory contract between the trust and its investment adviser. The complaint also charges various acts of self-dealing and other derelictions by the adviser in the course of its investment management. (A.3-21)

Thus, the instant case involves (1) collusive conduct between the investment adviser and the persons controlling the investment advisee; and (2) malfeasance occurring *after* the establishment of the investment advisory relationship. This case *does not* present the type of fraudulent conduct which the Investment Advisers Act was expressly established to prevent, *i.e.,* fraud committed by the adviser upon clients or prospective clients. *See* pp. 9-12, 18-19, *infra.*

Unlike the case of *Sullivan,* the case at bar involves *none* of the following facts relevant to determination of whether implied private remedies ought in any circumstances to be permitted under the Advisers Act: (1) face-to-face dealing between the investment adviser and the persons who are alleged to have suffered the damage; (2) direct damage to the person or entity being advised; (3) (and most importantly) fraudulent inducement by the investment adviser causing members of the public to entrust their assets to the adviser's management. As petitioners argue herein, Transamerica Mortgage Adviser, Inc. ("TAMA"), the instant defendant adviser, "has never advertised its services, solicited additional clients or held itself out in any way as a public investment adviser." Brief for Petitioners at 3-4.

In addition, it is questionable in the case at bar whether the defendant adviser, TAMA, is in fact an investment adviser at all within the meaning of the Advisers Act (R.250-52, R.357-58), or whether TAMA rendered advice with respect to a "security" as that term is defined by the Advisers Act § 202(a)(18) (R.350-56). TAMA raised these points before the district court and the Court of Appeals, which left them undecided. TAMA has not presented these issues in its petition for *certiorari;* this should not obscure the fact that, on TAMA's own analysis of this case, the question of the existence of a private right of action for damages under the Advisers Act is *moot* because the Advisers Act does not apply to its activities. See also Note 9, *infra.*

That the case at bar does not call into scrutiny the serious question whether members of the general public who are fraudulently induced into establishing an investment advisory relationship have a federal remedy is but the first of the flaws of this case. More serious, perhaps, is the

shabby state of the record below. In the case at bar, there was no written opinion offered below by the district court. The opinion below by the Court of Appeals was quite cursory, relying exclusively upon the majority opinion in *Abrahamson v. Fleschner,* 568 F.2d 862 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978). Moreover the respondent in the instant case might fairly be characterized as an habitual plaintiff. See cases mentioned in Petition for Writ of Certiorari at 6 and n.3.

Amici submit that the cause of justice will be better served by this Court's awaiting a more appropriate case presenting unambiguously, with a fuller factual record and the benefit of careful draftsmanship by the courts below, the important question of what remedies are available to investors who are defrauded by investment advisers in violation of the duties imposed upon such advisers by Congress.

B. The Court Should Find There Is an Implied Right of Action for Damages Under the Advisers Act.

Applying the four-pronged test of *Cort v. Ash,* 422 U.S. 66 (1975), *amici* urge that members of the public who have employed the services of an investment adviser and who have been injured by a violation of § 206 of the Advisers Act have an implied right of action for damages under the Advisers Act.

1. CLIENTS OF INVESTMENT ADVISERS ARE THE CLASS FOR WHOSE ESPECIAL BENEFIT THE STATUTE WAS ENACTED.

As the district court declared in *Sullivan,* 434 F.Supp. at 180:

> Congress enacted the Investment Advisers Act explicitly for the protection of whose who employ investment advisory services:

> "The essential purpose of [the Act] is to protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts . . ." H.R. Rep. No. 2639, 76th Cong., 3d Sess. 28 (1940).
>
> "[T]he dangerous potentialities of stock market tipsters imposing upon unsophisticated investors, convinces this committee that protection of investors requires the regulation of investment advisers on a national scale." S. Rep. No. 1775, *supra*, at 21.

The district court went on to conclude that "the Investment Advisers Act . . . is for 'the protection of investors.'" *Id. Accord, Abrahamson v. Fleschner, supra,* 586 F.2d at 873.[5]

The district court in *Sullivan* echoed the prior sentiments of the district court in *Bolger v. Laventhol, Krekstein, Horwath & Horwath,* 381 F.Supp. 260, 263 (S.D.N.Y. 1974), where the court concluded that "Congress determined that persons who paid for investment advice needed protection from dishonest and self-dealing advisers," and that "persons who were defrauded out of substantial sums of money by their investment advisers, fall squarely within the class

5. Although *Abrahamson* was decided before the filing of the district court's opinion in *Sullivan*, the *Sullivan* opinion was reasoned and written independently of the Second Circuit's decision in *Abrahamson*. *See* 434 F.Supp. at 179, n.9. Indeed, the *Sullivan* opinion treats the issue of private remedies under § 206 of the Advisers Act at greater length than does the *Abrahamson* majority, and applies the *Cort v. Ash* test with greater rigor, while reaching the same conclusion as does the majority in *Abrahamson*. It is unfortunate that, in dissenting from the Advisers Act portion of *Abrahamson*, Judge Gurfein did not have the benefit of Judge Renfrew's reasoning in *Sullivan*. Judge Gurfein's complaint that the *Abrahamson* majority failed to apply all four *Cort v. Ash* factors with equal rigor, *see* 568 F.2d at 881-82, is patently inapplicable to the careful analysis in *Sullivan* of how a private damage remedy for violation of § 206 of the Advisers Act is consonant with each factor of *Cort v. Ash*, and is compelled by the collective force of the four factors, *see* 434 F.Supp. at 179-184.

of persons whom the anti-fraud provisions of Section 206 [of the Advisers Act] were intended to protect."

Although petitioners herein correctly state that *Bolger* was decided prior to *Cort v. Ash,* Brief for Petitioners at 12 & n.17, they incorrectly state (contrary to the above-quoted passage from *Bolger*) that the *Bolger* court did not consider whether the Advisers Act was adopted for the special benefit of persons defrauded out of money by investment advisers.

The issue as stated by petitioners is whether "The Advisers Act Was Enacted for the Special Benefit of *Investors Seeking Money Damages* for Violations of the Act." Brief for Petitioners at 11 (emphasis added). It appears that petitioners thus mean to contend, with more guile than logic, that *Bolger's* finding that the Advisers Act protects investors who were "defrauded out of substantial sums of money" is unsupportive of the proposition that the Advisers Act was enacted for the benefit of investors who are "seeking money damages for violations of the Act."

Quite apart from utterly failing as a basis for distinguishing *Bolger,* the articulation of the issue in these terms is distinctly conclusory. Like the Mad Hatter serving tea to Alice, petitioners herein propose to allow defrauded investors an *implied* private remedy for damages only when their statutory cup has already been filled by an *express* provision for money damages. Absent such an express remedy, petitioners argue, there is insufficient evidence of intent to protect investors to permit recognition of an implied remedy. Petitioners should return to the other side of the looking-glass of legislative intent.

Petitioners' reasoning appears to be incompatible with the recognition, in *Cort v. Ash,* that in certain circum-

stances the intent of Congress can only be effectuated through implied remedies.

The starting point for this analysis is identification of the intended beneficiaries of statute. In the instant case, reference hardly need extend beyond the words of § 206 of the Advisers Act itself, 15 U.S.C. § 80b-6: "It shall be unlawful for any investment adviser . . . to employ any device, scheme or artifice to defraud [or] to engage in any transaction, practice, or course of business which operates as a fraud or deceit *upon any client or prospective client.*" (Emphasis added.) And indeed, this Court has already ruled that these very words were intended by Congress to be given "a broad and *remedial* construction." *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.* 375 U.S. 180, 185-195 (1963) (emphasis added).

Amici submit that it is beyond serious dispute that members of the public who are defrauded by investment advisers were intended to be the especial beneficiaries of § 206 of the Advisers Act.

2. THERE IS NO INDICATION OF CONGRESSIONAL INTENT TO DENY AN IMPLIED RIGHT OF ACTION FOR DAMAGES.

The district court in *Sullivan* rejected, after extensive consideration, the argument that the absence of "actions at law" language in § 214 of the Advisers Act indicates an intent by Congress not to allow private damage actions. 434 F.Supp. at 180-82. The *Sullivan* court concluded that "§ 214 casts no light on whether Congress would have approved or disapproved of an implied right of action under § 206." *Id.* at 182.

However, the *Sullivan* court did find evidence of Congressional intent supportive of private remedies in the language of Advisers Act § 215, which provides that any contract made in violation of the Act "shall be void." This

was found in *Sullivan* to be an unmistakable indication that "Congress intended private individuals to seek at least *some* form of private remedy under the Act." 434 F.Supp. at 182 (emphasis added).

This "shall be void" provision would be manifestly impotent if the absence of *any* private remedy under the Advisers Act reduced it to a statutory affirmative defense to be asserted in the unlikely event that an investment adviser who fraudulently induces a client to enter into an investment advisory contract, later sues the client on the contract. Indeed, it was the seeming inanity of giving such a construction to the parallel provision of the Securities Exchange Act of 1934 ("Exchange Act"), § 29(b), 15 U.S.C. § 78(cc)(b), which impelled the court to imply a private right of action for violation of Rule 10b-5 in *Kardon v. National Gypsum Co.*, 69 F.Supp. 512, 514 (E.D.Pa. 1946), the tap root for all subsequent cases recognizing implied rights of action under New Deal Securities acts. *See* 3 Loss, *Securities Regulation,* 1761-63 (2d ed. 1961).

Indeed, even Judge Gurfein, in dissenting from the *Abrahamson* majority's implication of a private right of action for damages under § 206 of the Advisers Act because of his construction of § 214 as disallowing any such action *at law* for damages, was willing to concede that §§ 214 and 215 could be harmonized by permitting a private action for *equitable* remedies such as rescission and restitution—remedies which, *inter alia,* are sought by the *Sullivan* plaintiffs. In the words of Judge Gurfein, "implication of a private right of action for rescission and restitution under § 215(b) would be well within the jurisdictional grant of § 214, and consistent with the notion that it is only *actions at law* which are inconsistent with the statutory scheme." 568 F.2d at 882 n.8 (emphasis in original).

As with the first prong of the *Cort v. Ash* test for implied statutory remedies, petitioners bend the second prong into a tautology. Petitioners claim to have won the point by purporting to demonstrate that there is no "clear" (Brief for Petitioners at 14) indication of Congressional intent to provide injured clients of investment advisers with a damages remedy. Of course, the clearest indication of Congressional intent would be provision of an express remedy. But if this were the test, *Cort v. Ash* would be a superfluous exercise in the dynamics of the judicial construction of statutes.

As support for the tautological proposition that only "clear" evidence of intent to create a remedy will permit implication of a remedy, petitioners ignore *Cort v. Ash* and turn instead to distorted excerpts from the pre-*Cort v. Ash* cases of *National Railroad Passenger Corp. v. National Ass'n of Railroad Passengers,* 414 U.S. 453, 458 (1974) (*"Amtrak"*), and *Securities Investor Protection Corp. v. Barbour,* 421 U.S. 412, 419 (1975). See Brief for Petitioners at 14, 20-21. In *Amtrak,* this Court invoked the "frequently stated principle of statutory construction" that the express provision of certain remedies in a statute—in that case both a public cause of action and an express, but narrowly circumscribed, private cause of action—should be taken as an implied negation of any further means of enforcing that statute. 414 U.S. at 458. However, this Court qualified the application of that canon of construction by observing that "even the most basic general principles of statutory construction must yield to clear contrary evidence of legislative intent," *id.,* and went on to review the legislative history of the Amtrak Act in question. In both *Amtrak* and *Barbour* (which tracked the *Amtrak* analysis), the legislative history was found to be "clear[ly] incompatible with . . . an implied right [of action]." *Barbour,* 421 U.S. at 421.

Against this background was written Mr. Justice Brennan's opinion for a unanimous Court in *Cort v. Ash.* Mr. Justice Brennan made it clear that the second prong of the *Cort v. Ash* analysis, which looks for "any indication of legislative intent, explicit or implicit, either to create [a private] remedy or to deny one," 422 U.S. at 78, was meant to dispel any inference in *Amtrak* that express evidence of Congressional intent was required if private remedies were to be implied in an act which provided any express remedies at all. "True," wrote Mr. Justice Brennan, "in situations in which it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an intention to *create* a private cause of action, although an explicit purpose to *deny* such cause of action would be controlling." 422 U.S. at 82 (emphasis in original). Mr. Justice Brennan added a lengthy footnote to drive this point home, specifically declaring the construction of *Amtrak* adopted by petitioners herein, under which there arises an inference of Congressional intent to deny implied private remedies if a statute contains any express remedies at all to be an "entirely unilluminating" "excursion into extrapolation of legislative intent." 422 U.S. at 82 n. 14.

There should, at this time, be no doubt on this issue. Under the controlling principles of *Cort v. Ash,* the second prong looks for any evidence in the legislative history of an intent either to create or deny private remedies, but in no way demands as a condition precedent to further analysis some affirmative showing of legislative intent to create private remedies. The second prong of *Cort v. Ash* is dispositive only when the review of legislative history shows, as in *Amtrak,* "specific support . . . for the proposition that the statutory remedies were to be exclusive." *Cort v.*

Ash, 422 U.S. at 82 n. 14, citing *Amtrak,* 414 U.S. at 458-461.

As petitioners appear to recognize, there is very little evidence of Congressional intent either to create or to deny private damage remedies for Advisers Act violations. See Brief for petitioners at 20-21. Petitioners pursue two strategies in an attempt to demonstrate some shred of legislative intent antagonistic to such remedies. First, petitioners rely on the omission from § 214 of a jurisdictional provision for "actions at law," and see this as combining with the lack of any express provision for civil damages by the Advisers Act to provide evidence of Congressional disinclination to allow private remedies. As authority, petitioners invoke Judge Gurfein's opinion in *Abrahamson,* which ignores *Cort v. Ash* on this point and instead applies the very interpretation of *Amtrak* which *Cort v. Ash* unanimously disapproved. See *Abrahamson v. Fleschner, supra,* 568 F.2d at 882-83 (separate opinion).

Petitioners fail to account for the majority opinion in *Abrahamson,* which properly found the second prong of *Cort v. Ash* to bend neither for nor against implication of a private remedy because "it is clear that Congress simply did not consider the matter." 568 F.2d at 875. *Accord, Wilson v. First Houston Investment Corp.,* 566 F.2d 1235, 1240-42 (5th Cir. 1978). Petitioners also ignore the plenary consideration of this very point in Judge Renfrew's *Sullivan* opinion, 434 F.Supp. 180-82 & n. 16, which concludes in the same vein as the *Abrahamson* majority that the language and legislative history of the Advisers Act is inconclusive as to Congressional approval or disapproval of private remedies.[6]

6. This is also the conclusion of the editors of the Michigan Law Review, see Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act,* 74 Mich.L.Rev. 308, 316-20 (1975), which petitioners cite as if it were supportive of their purported discovery of legislative intent antithetical to private remedies under the Advisers Act. See Brief for Petitioners at 16 & n. 23. In fact, the Michigan Note provides detailed and scholarly support for the proposition that "an examination of section 206 in light of [*Cort v. Ash's*] four factors clearly suggests that courts should imply private rights of action in favor of those injured by its violation," 74 Mich.L.Rev. at 314, and concludes that "[t]he similarities between section 206 and rule 10b-5 and the need for private enforcement of section 206 to supplement SEC efforts strongly recommend the judicial implication of a cause of action under that provision," *id.* at 348.

The second strategy which petitioners pursue to construct evidence of Congressional intent where none in fact exists is to point to the failure of Congress to amend the Advisers Act to insert a private right of action for damages. Petitioners admit that such an endeavor leaves them "not unmindful of the limits inherent in 'mute intermediate legislative maneuvers.'" Brief for Petitioners at 20. And well they might be abashed, for this Court has expressly declared, in the exact context of the interpretation of the Advisers Act and the effect of subsequent amendments on the construction of unamended portions, that "the intent of Congress must be culled from the events surrounding the passage of the 1940 legislation. '[O]pinions attributed to a Congress twenty years after the event cannot be considered evidence of the intent of the Congress in 1940.'" *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 199-200.

Moreover, as a matter of logic, quite apart from the impropriety of looking to subsequent Congresses for evidence of the intent of an earlier enactment, the failure of Congress to supply a private remedy by amendment seems more indicative of the pre-existing availability of an implied private remedy under a sound construction of the original text of the Advisers Act, than of the contrary.

Amici conclude that there is inconclusive evidence of an intent on the part of Congress either to create or to deny an implied right of action for damages under the Advisers Act. The language of § 215 of the Advisers Act, providing that contracts violative of the Act "shall be void," is certainly suggestive of an intent to allow equitable remedies to private persons harmed by violations of the Advisers Act, and since the award of a restitutionary measure of damages is but a species of the equitable remedy of rescission and restitution, see Jacobs, *The Measure of Damages in Rule 10-b5 Cases,* 65 Geo.L.J. 1093, 1109-1120 (1977), this suggestion provides some support for implication of a private right of action for damages. But this makes the second prong of *Cort v. Ash* only lean in the direction advocated by *amici,* and makes the analysis of the applicability of the third prong of *Cort v. Ash* particularly crucial.

3. AN IMPLIED RIGHT OF ACTION IS CONSISTENT WITH—AND NECESSARY TO EFFECTUATE—THE UNDERLYING PURPOSES OF THE ADVISERS ACT.

As this Court has already noted in *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 189-90, the "declaration of policy", accompanying the original bill which, with some changes, became the Investment Advisers Act of 1940 stated in pertinent part:

> "[I]t is hereby declared that the national public interest and the interest of investors are adversely affected—. . . (4) when the business of investment advisers is conducted so as to defraud or mislead investors. . . .
>
> "It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to *mitigate and,* so far as is presently practicable to *eliminate* the abuses enumerated in this section." (Citing to S.3580, 76th Cong. 3d Sess., § 202; emphasis added.)

The major abuse addressed by the Act was adviser fraud. "The broad proscription against 'any practice . . . which operates . . . as a fraud or deceit upon any client or prospective client' remained in the bill from beginning to end." 375 U.S. at 191.

The Advisers Act, being the "last in a series of Acts designed to eliminate certain abuses in the securities industry" was, along with the other securities acts, designed "to achieve a high standard of business ethics in the securities industry." 375 U.S. at 186.

Other courts have echoed this Court's views on the purpose of the Advisers Act. The majority in *Abrahamson v. Fleschner, supra,* found that "the purpose of the Advisers Act was to 'protect the public and investors against malpractice by persons paid for advising others about securities'" (citing to S. Rep. No. 1760, 86th Cong., 2d Sess. 1 (1960)). 568 F.2d at 873. The district court in *Sullivan* concluded that § 206 was enacted for the purpose of the protection of investors. 434 F.Supp. at 183. Finally, the majority in *Wilson v. First Houston Investment Corp., supra,* concluded that "Congress sought to protect investors from the "'problems and abuses of investment advisory services' by regulation of the industry." 566 F.2d at 1242.

The implication of a private right of action for persons damaged by violations of the Advisers Act is both *consistent with* and *necessary* "to make effective the [above-stated] congressional purpose" underlying the Advisers Act. *J. I. Case Co. v. Borak,* 377 U.S. 426, 433 (1964).

Unlike the situation in *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), the implication of a private damage remedy *would* confer an "advantage on the expressly protected class" whose welfare motivated Congress to pass the Advisers Act. 430 U.S. at 38. Unlike *Piper, supra*, the plaintiff in the instant case is not a person "whose conduct the statute is designed to regulate." 430 U.S. at 39. Also unlike the situation in *Piper, supra*, the plaintiff seeking damages under the Advisers Act will not typically be a corporate giant proposing to acquire by litigation what it could not acquire in the marketplace. Although the instant case does involve a corporate investment advisory client, the *Sullivan* case demonstrates that the rights to recovery of many small investors hang in the balance of the Court's decision herein.

Even if the third prong of the *Cort* test poses the questions whether a private right of action would be not only "consistent" with a statute's underlying legislative purpose but also "necessary" to effectuate those purposes, *see Sullivan*, 434 F.Supp. at 182 n. 17, *amici* submit that an implied right of action for damages is, as the district court in *Sullivan* found, "both consistent with and necessary to achieving Congress's underlying purpose in enacting the Investment Advisers Act." *Id.*

This Court in *J. I. Case Co. v. Borak, supra*, allowed private enforcement of the proxy rules as "a necessary supplement to Commission action." 377 U.S. at 432. One of the Court's considerations was that the Securities and Exchange Commission "examines over two thousand proxy statement annually and each of them must necessarily be expedited." *Id.* at 432.

Similar considerations apply to provide enforcement of the Advisers Act. The district court in *Sullivan* found that as of December 31, 1976, 4,328 investment advisers were

registered with the Commission. 434 F.Supp. at 183. Given that § 206 of the Investment Advisers Act appears to apply to *unregistered*[7] as well as registered investment advisers and that promotional materials to be used by registered investment advisers do not even have to be submitted to the Commission (as do proxy statements), there is an imperative need to supplement Commission enforcement of § 206 of the Advisers Act with the deterrent prospect of private damages actions.

As the history of the *Sullivan* case shows, it is virtually impossible for the Commission to enforce § 206 of the Advisers Act until after the offense occurs. The limited nature of the Commission's resources results in few litigated cases; of these few, most are settled by means of consent decrees enjoining future violations. Such enforcement proceedings are prophylactic without in any sense being remedial. While certainly helpful to effectuate the purposes of the Advisers Act, their result is to leave the wrongdoers warmly wrapped in their ill-gotten gains while providing no comfort to those who have been fleeced prior to the initiation of the Commission action. As the district court in *Sullivan* noted, "private damage actions may be the only way injured investors can recover money they have lost to dishonest investment advisers." 434 F.Supp. at 183.[8]

The majority in *Abrahamson v. Fleschner, supra*, expressed the same sentiment by declaring that "the courts consistently have recognized that the Commission's resources are inadequate to the task of policing alone the federal securities laws" as a basis for concluding that

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7. Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, *supra* note 6, at 311 n. 18.

8. The plaintiff class in *Sullivan*, without a private remedy, will be unable to recover the millions of dollars in advisory fees and brokerage commissions generated by their adviser's alleged violations of the Advisers Act.

"[f]ailure to recognize a private right of action under the Advisers Act would effectively frustrate [its] purpose[s]." 568 F.2d at 874.

The contrast between the policing of the Amtrak system as described in *National Railroad Passenger Corp. v. National Association of Railroad Passengers,* 414 U.S. 453 (1974) and the policing of thousands of registered and unregistered investment advisers to enforce the duties and obligations imposed by Congressional legislation is significant. The Amtrak system is subject to "substantial scrutiny . . . by both Congress and the Executive". 414 U.S. at 464. Clothing the Attorney General with the exclusive power to enforce the Amtrak Act (except in cases involving labor agreements) was found by this Court to have been considered by Congress to be a sufficient enforcement mechanism to police Amtrak obligations under the Act. Yet the sheer numbers and wide-ranging activities of investment advisers and the lack of "substantial scrutiny" of them are strong reasons for supplementing Commission enforcement activity by private remedies.

Moreover, public enforcement of the Amtrak Act appears much more preferable in view of the millions of railroad passengers who might bring suit were a private remedy available. Violations of § 206 of the Advisers Act damages far fewer people far more directly, and private enforcement is, therefore, much more feasible.

As Mr. Justice Stevens wrote in his dissenting opinion in *Piper, supra,* "it is fundamental in our adversary system that the selfish interest of the litigant provides the best guarantee that a claim will be effectively asserted." 430 U.S. at 62. He went on in a footnote to point out that "'there is no policeman so effective as the one whose pocketbook is affected by the degree to which he enforces the law'" *id.* at 62 n.14.

If preventing fraud by investment advisers is, as petitioners have grudgingly conceded, Brief for Petitioners at 23-24, a main purpose of the Advisers Act, recovery of money damages is the only way that § 206 can be expected to achieve its purposes with reasonable certainty and consistency—purposes which are *remedial* as well as prophylactic. By taking the profit out of completed advisory fraud, a private right of action for damages caused by violation of § 206 will effectuate both important purposes.

4. THE CAUSE OF ACTION IS NOT ONE TRADITIONALLY RELEGATED TO STATE LAW.

This Court recognized in *Capital Gains, supra,* "the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities." 375 U.S. at 194.

At the time the Advisers Act was enacted, the investment advisory industry was a "fledgling profession." *Capital Gains, supra,* 375 U.S. at 191 n.34. One of the fundamental purposes of the Advisers Act, as well as the other securities acts, "was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *Capital Gains, supra,* 375 U.S. at 186. The "philosophy of *caveat emptor*" is, of course, the philosophy of the common law which the Advisers Act was meant to change.

It is now beyond cavil that "Congress intended the Investment Advisers Act to establish *federal* fiduciary standards for investment advisers." *Santa Fe Industries, Inc. v. Green,* 430 U.S. 462, 471 n.11 (1977) (emphasis added). Given that it is a breach of a *federal* fiduciary duty which is before this Court, it is "for federal courts to fashion federal law where federal rights are concerned." *Textile*

Workers Union of America v. Lincoln Mills of Alabama, 353 U.S. 448, 457 (1957).

The implication of a private remedy which the SEC believes would be "a valuable adjunct to Commission enforcement", *Sullivan,* 434 F.Supp. at 183, is not in conflict with the concern of *Cort v. Ash* over supplanting "whatever remedy is created by state law." *Cort v. Ash, supra,* 422 U.S. at 84.

There is an almost total absence of state laws providing private remedies against investment advisers. The district court found at the time of its opinion in *Sullivan* that "[a]lthough 27 states now have anti-fraud statutes regulating investment advisers, most were enacted well after 1940, and only one provides for a private cause of action." [Citing H.R. Doc. No. 477, 76th Cong. 2d Sess. at 31-33 (1939) and Note. *Private Causes of Action Under Section 206 of the Investment Advisers Act,* 74 Mich.L.Rev. 308, 324 & n.103 (state statutes collected).] 434 F.Supp. at 184.

Unlike the fact pattern in *Santa Fe Industries, Inc. v. Green, supra,* the extension of the Investment Advisers Act to provide a private remedy would not "overlap and quite possibly interfere with state . . . law." 430 U.S. at 479. There is no need, as would have been the case in *Santa Fe Industries, supra,* "to federalize [a] substantial portion of [state] law [so that] established state policies . . . would be overriden." 430 U.S. at 479.

Even assuming there exist state remedies available which approach the flexibility of the federal standards of advisory fraud as explicated in *Capital Gains, supra,* or which are consonant with the federal fiduciary duties of investment advisors, only the aggregation of resources possible through a nation-wide class action make litigation to redress nationwide advisory fraud practicable. No state cause of action

can be litigated on a nation-wide basis. Yet, a nation-wide class is essential for effective redress of nation-wide securities fraud. This was the approach taken by the district court in *Sullivan, supra,* in which the court found that "Congress unquestionably intended the Investment Advisers Act to provide 'regulation of investment advisers on a national scale . . . [T]he solution of the problems and abuses of investment advisory services . . . cannot be effected without federal legislation'" (citing to S. Rep. No. 1775, 76th Cong., 3d Sess. at 21 (1940)). 434 F.Supp. at 184.

The vagaries of state law are ill-equipped to provide relief to those who have been ensnared by investment advisory fraud. The Advisers Act recognizes this, and provides both standards of care and the prospects of effective redress.

CONCLUSION

Those of the investing public who are least able to fend for themselves seek the seemingly safer haven offered by investment advisers. Investment advisers who commit nationwide fraud in soliciting clients can no more effectively be held to account for damages under state law alone than can those who fraudulently purchase or sell securities. There is no basis in law or reason for advisers to have more freedom to commit fraud in the securities marketplace than broker-dealers. This Court has already construed the Advisers Act as the last Congressional arrow aimed at the dragon of *caveat emptor. Securities and Exchange Commission v. Capital Gains Research Bureau, supra,* 375 U.S. at 186. If this Court holds there is no private remedy for violation of the Advisers Act, that Act will be an arrow without a point. The dragon of *caveat*

emptor will be free to prowl again, and investment advisory clients will surely be among its easier prey.

Indeed, it seems the height of irony that, if the judgment below is reversed without due circumspection, investors who display wariness of the market place by seeking investment advice will be more at the mercy of *caveat emptor* than sophisticated investors who are bold enough to deal directly with the market without seeking the security of investment advisers.

Can it really be the intent of Congress that investors fleeced in the impersonal market place are to be clothed in the folds of the private right of action for damages implied under § 10 of the Exchange Act, while investors fleeced in direct, face-to-face dealing with their federally regulated investment advisers are afforded only the cold comfort of an opportunity to complain about their faithless federal fiduciaries to the self-admittedly overburdened SEC?

It is for this Court to effectuate the intent of Congress to protect investors from advisor fraud. To paraphrase Mr. Justice (then Judge) Cardozo, the Advisers Act is "'instinct with an obligation,' imperfectly expressed." *Wood v. Lucy, Lady Duff-Gordon,* 22 N.Y. 88, 90, 118 N.E. 214 (1917). To admit the imperfection of no express private remedy for violation of § 206 is no basis for eviscerating § 206's mandate to investment advisers not "to defraud any client or prospective client." Congress has made the obligation clear; this Court should correct the imperfection of expression by implying the remedy needed to make the obligation meaningful.

Whether or not in this particular case the conduct alleged constitutes "fraud" under § 206, this Court should ensure that where § 206 has indisputably been violated,

"any client or prospective client" harmed thereby has a federal remedy to provide redress. This can best be accomplished by affirming the court below as to the only issue petitioners chose to present on *certiorari,* the basic issue of the existence in an appropriate case of a private right of action under the Advisers Act.[9]

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January 31, 1979

9. There were several issues raised by the petitioners herein for its review which the Court of Appeals declined to consider and adjudicate prior to trial court consideration. *Lewis v. Transamerica Corp.,* 575 F.2d 237, 238 (9th Cir. 1978), *cert. granted,* ..... U.S. ....., 99 S.Ct. 348 (1978). Any one of those issues might be dispositive of the case at bar without reaching the question whether to imply a private right of action under the Advisers Act.

Addendum

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 449/March 28, 1975

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 11322/March 28, 1975

Admin. Proc. File No. 3-4635

In the Matter of

CHASE INVESTMENT SERVICES
OF BOSTON, INC.
535 Boylston Street
Boston, Massachusetts
(801-7435)

JOHN P. CHASE, INC.
535Boylston Street
Boston, Massachusetts
(801-5995)

JOHN P. CHASE
Wilsondale Street
Dover, Massachusetts

LAWRENCE M. TILTON
Linea Del Cielo
P. O. Box 1841
Rancho Santa Fe, California

JACK W. SWENSON
112 Thunder Road
Sudbury, Massachusetts
(801-10330)

FINDINGS AND ORDER IMPOSING REMEDIAL SANCTIONS

I.

John P. Chase ("Chase") has been in the investment advisory business in Boston for many years.[1] Chase is Chairman of the Board of John P. Chase, Inc. ("JPC"), a registered investment adviser.[2] JPC's clientele consists of institutions and of individuals with accounts of $500,000 or more.[3] JPC has about $475 million under management.

Chase Investment Services of Boston, Inc. ("CIS"), a wholly-owned subsidiary of JPC and itself a registered investment adviser, serves smaller accounts.[4] CIS's minimum account is $25,000. It manages about 480 accounts with aggregate assets of some $18 million.[5] CIS's policies are shaped by its parent, JPC.[6]

1. His attorneys state that "he has been a leader in the financial community for over 42 years."

2. Until April of 1974, Chase was also JPC's chief executive.

3. The present JPC, a wholly owned subsidiary of Continental Investment Corporation (of which Chase is a director and a stockholder), is the successor to another corporation of the same name. References to JPC in this document relate to both the present company and its predecessor.

4. Just as there was an old JPC and a new one, so too there was an old CIS and a new one. The old CIS was called Chase Investment Services, Inc. It did not have the phrase "of Boston" in its name. CIS is used in this document to refer to both companies.

5. CIS's business used to be substantially larger. From the beginning of 1967 to the present CIS managed the accounts of over 2,400 clients. The assets in those accounts totaled over $100 million.

But in 1972, 1973 and 1974, over 1,000 clients cancelled their investment advisory contracts with CIS. Most of them did so after sustaining substantial losses. Until about March of 1973 CIS gave no rebates to clients who cancelled before the end of the period covered by the fee that they had already paid.

6. Chase is CIS's treasurer and also serves on its Board of Directors.

Lawrence M. Tilton and Jack W. Swenson were formerly associated with CIS and JPC. Tilton was CIS's president and directed the effort to market its services. He was also a vice president of JPC. Swenson, CIS's chief portfolio manager, was also its executive vice president as well as a vice president of JPC. Swenson recently entered the investment advisory business on his own account as a sole proprietor. Accordingly, he is now himself a registered investment adviser.

II.

To determine whether certain allegations about the above-named respondents are true and what remedial action, if any, ought to be taken, this proceeding was instituted under the Investment Advisers and Securities Exchange Acts. Solely for the purpose of disposing of this matter and without admitting or denying the allegations in the order for proceedings, Chase, CIS, JPC, Tilton and Swenson have made offers of settlement. The Commission's staff recommends that those offers of settlement be accepted. And the Commission has decided to do so.

No evidentiary hearing has been held. The findings made below rest entirely on the allegations in the order for proceedings and on the offers of settlement. Respondents have consented to the sanctions that this order imposes.

III.

CIS offers what it calls professional investment management or investment counsel service. For this it charges an annual fee of 2% of the first $75,000 under management plus lower percentages on those portions of a particular account's assets in excess of that figure.[7] The first year's

7. CIS raised its rates in August of 1970. Up to that time it charged 2% of the first $25,000 under management, 1% of the next $25,000 and one-half of 1% of the next $250,000.

fee is paid at the outset. Subsequent fees are paid semi-annually in advance and are generally deducted from the client's account.

CIS, Swenson, and Tilton represented that CIS:[8]

(A) Gave smaller investors professional investment management and investment counsel tailored to the client's personal requirements;

(B) Provided such smaller investors with a service comparable to that furnished to the wealthy by JPC and other investment counsel firms;

(C) Made what was in effect a daily reappraisal of all factors affecting the particular account; and

(D) Managed accounts flexibility, placing funds in bonds or short-term debt securities when the economic climate was unfavorable so as to establish reserves for the subsequent purchase of equity securities when the outlook for equities became more attractive.

These representations were materially false and misleading. CIS's service was in no way comparable to that provided by JPC. A CIS portfolio manager "supervised" from 300 to 500 accounts. JPC's portfolio managers, on the other hand, generally handled less than 60 accounts.

CIS clients did not get personalized treatment. No inquiry was made about their personal needs, financial requirements, tax situations, and ability to bear risks. And when such information was obtained, it was disregarded. When funds were not placed in equities, cash balances in clients' accounts lay idle and wholly unproductive.

8. With respect to CIS, the period in question runs from at least January 1, 1967 to the present. In Swenson's case the relevant period begins no later than January 1, 1967 and ends in July of 1974. In Tilton's case the relevant period runs from at least August 1, 1970 to October 31, 1973.

CIS assigned each client to one of three broad categories.[9] Investment decisions were made for these impersonal categories without regard to either the particular needs of the flesh and blood people in the categories or material changes in CIS's research positions. Thus a CIS client received about as much personal service as he would have gotten from a mutual fund. But the advisory fees and the brokerage commissions that he paid were substantially higher than those that he would have borne had he invested in a mutual fund.

IV.

From May of 1971 to June of 1973, CIS, Tilton, and Swenson represented that CIS had done well for its clients. More specifically, they said that all "growth-oriented" accounts under continuous CIS management in the four years between March 1967 and March 1971 had increased by an average of 89.7%. When that four year period was extended to a fifth year, the results became even more enticing. For the five years ending in March of 1972 an average increase of 106.6% was claimed.[10]

People were not told that:

(A) These dazzling results reflected the average performance of but five accounts. Even within that extremely limited sample performance varied widely.

(B) No audit of CIS's 1967-1971 investment results had been made.[11]

(C) Both CIS's overall performance and the investment results achieved by most of its growth-oriented accounts were far less favorable for the periods in question.

9. The category in which a person was placed depended on his investment objective.

10. CIS and Tilton claimed that these results had been audited by certified public accountants. Swenson, however, is not found to have done so.

11. See the preceding footnote.

(D) During other periods when CIS had a far larger volume of assets under management, most of its clients lost money.

V.

The fraudulent claims about past results were supplemented by representations that:

(A) CIS's goal for a client who had "maximum capital appreciation" as his objective was to double his money in five years—this goal was realistic; it had actually been achieved in the past.

(B) CIS's professional investment management could reduce the risks of investing.

(C) CIS invested prudently in securities of good quality and did not trade or speculate.

Actually, however, only four of CIS's "maximum capital appreciation" clients had doubled their money in five years. Moreover, CIS's investments were not broadly diversified. They were confined to a limited group of issues, most of which were risky and speculative. Clients were not told this.

Nor were those who stated their objective as maximum capital appreciation warned that they were likely to experience fluctuations significantly greater than those in leading market indicators (such as the Dow Jones Industrial Average) and substantial downside risk.

VI.

CIS relied heavily on referrals from brokers and dealers as a source of new clients.[12] Clients referred to CIS in this

12. It required each client to grant it discretionary authority to buy and sell securities without prior consultation with or comment from him. It also insisted that the client maintain an account with a broker. CIS would then execute all transactions through that broker. In most instances this business went to the broker who had referred the client to CIS in the first place.

way were not told that CIS was inducing brokers to send it business by splitting its advisory fees with the referring brokers.[13] Nor were clients told of another substantial benefit that went to the referring broker. CIS saw to it that referring brokers knew that the typical CIS account had a portfolio turnover of about 100% during the first year and of about 50% thereafter and that the extremely substantial brokerage commissions generated by all this activity would inure to the broker's benefit.[14]

VII.

From the foregoing it follows that:

(A) CIS, Tilton, and Swenson willfully violated and willfully aided and abetted each other's willful violations of the antifraud provisions of the Investment Advisers and Securities Exchange Acts.[15]

13. The kickbacks ranged from 10% to 25% and were not limited to the first year's fees.

14. See n. 12, *supra*.

15. Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act, and Rule 206(4)-1(a) under that statute. Section 10(b) of the Securities Exchange Act and the Commission's Rule 10b-5 thereunder. In addition, CIS willfully violated Section 203(c)(2) of the Investment Advisers Act which makes it unlawful for any registered investment adviser "to represent that he is an investment counsel or to use the name 'investment counsel' as descriptive of his business unless . . . a substantial part of his or its business consists of rendering investment supervisory services." The term "investment supervisory services" is defined in Section 202(a)(13) of the Act as "the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client." As a well-known treatise says, "The criterion for the use of the descriptive term 'investment counsel' is . . . the continuity and personalized nature of the advice . . . ." 2 Loss, Securities Regulation 1413 (2d ed. 1961). It is further found that Tilton and Swenson willfully aided and abetted CIS's willful violations of this section.

(B) JPC and Chase himself failed reasonably to supervise with a view to preventing the aforementioned violations.[16]

VIII.

The Commission's conclusion that the sanctions to which the respondents have consented are sufficient to vindicate the public interest and appropriate for the protection of investors was influenced by CIS's undertaking—joined in by JPC—to:

(A) Develop standards and procedures to assure each investment advisory client of personalized treatment;[17]

(B) Deliver a written statement to prospective clients disclosing all material facts about CIS's advisory service, including CIS's investment methods, the risks inherent in those methods as well as the risks incident to any form of investment in securities, personnel, sources of research, and means and methods of executing brokerage transactions.

16. They thus violated Section 203(e)(5) of the Investment Advisers Act.

17. This will involve:
(i) Obtaining information about the client's needs and investment objectives;
(ii) Affording the client an opportunity to discuss this information.
(iii) Having reasonable grounds to consider the service suitable to the particular prospect's needs;
(iv) Having reasonable grounds to believe that investment decisions are suitable to the client's particular needs;
(v) Reviewing each client's account on a continuous basis;
(vi) Giving each client reasonable access to his account bearer;
(vi) Giving each client reasonable access to his account manager;
(vi) Establishing minimum with respect to account size and personnel requirements as well as limitations on the number of accounts to permit personalized investment treatment to the client; and
(viii) Providing a procedure for investing the idle cash in clients' accounts in an interest-bearing account or in a security or for withdrawing such cash from CIS' supervision.

(C) Monitor and establish reasonable supervisory controls on sales presentations made by CIS personnel and by other persons on CIS's behalf;

(D) Establish a central file, which will contain a copy of any complaint letter from or on behalf of a CIS client; a memorandum of any complaint received verbally from or on behalf of a CIS client; a copy of any written response by CIS and/or a memorandum of CIS's action in response to the complaint;

(E) Develop other recordkeeping and review practices that will help implement the procedures spoken of in paragraph (C) hereinabove;

(F) Proscribe any fee-splitting arrangements;

(G) Develop other procedures to protect the integrity of CIS's relationship with its clients and to assure CIS's independence from brokers and dealers;

(H) Have the foregoing standards and procedures as well as all sales literature and practices reviewed by counsel;

(I) Submit a memorandum to the Commission's Division of Enforcement containing a detailed description of the new procedures that CIS has established and of the methods by which these procedures will be implemented (this memorandum is to be furnished within 30 days from the date hereof);

(J) Retain an independent consultant, satisfactory to the Commission's Division of Enforcement, who will review CIS's new procedures and their implementation and report his findings to the Commission's Division of Enforcement;[18] and

(K) Preserve all of its books and records and those of its predecessor for five years.

18. This person is to be appointed approximately one year from the date hereof.

Swenson has submitted an undertaking comparable to CIS's with respect to his future conduct as a self-employed investment adviser. He also states that:

> "[F]or a time after the inception of CIS's advisory service, he attempted—within . . . limits . . . — to render personalized treatment to those clients who had initial contact with him. However, as the service grew he was directed by his superiors on a number of occasions to limit personal contact with clients and to restrict his activities to the office management of portfolios."

Tilton states "that since October 31, 1973, he has not engaged in any way in any aspect of the investment advisory or broker-dealer business" and that he "has no present intention to engage in the investment advisory or broker-dealer business." Accordingly, he undertakes neither to register as an investment adviser or a broker-dealer nor to associate himself with any registered investment adviser or broker-dealer.

IX.

Accordingly, It Is Ordered that John F. Chase, Inc., Chase Investment Services of Boston, Inc., Lawrence M. Tilton, and Jack W. Swenson be, and they hereby are, required to do all that they have undertaken to do in their offers of settlement herein and in the undertakings annexed thereto; and it is further

Ordered that John F. Chase, Inc. and Chase Investment Services of Boston, Inc. be, and they hereby are, suspended for the 180 days beginning at the opening of business on March 31, 1975, from soliciting or accepting new investment advisory clients for or on behalf of Chase Investment Services of Boston, Inc.; and it is further

Ordered that Chase Investment Services of Boston, Inc. serve its existing clients at cost during the aforementioned 180-day suspension period; and it is further

Ordered that John P. Chase be, and he hereby is, suspended from associating himself with any investment adviser for the 30 days beginning at the opening of business on March 31, 1975; and it is further

Ordered that the registration of Jack W. Swenson as an investment adviser be, and the same hereby is, suspended for the 30 days beginning at the opening of business on April 16, 1975; and it is further

Ordered that the said Jack W. Swenson be, and he hereby is, suspended from association with any investment adviser for the 30 days that will begin at the opening of business on April 16, 1975; and it is further

Ordered that Lawrence M. Tilton refrain from either registering with the Commission as an investment adviser or a broker-dealer or associating himself with any registered investment adviser or any registered broker-dealer without the Commission's prior written approval.

For the Commission by the Office of Opinions and Review, pursuant to delegated authority.

George A. Fitzsimmons
Secretary

By: Shirley E. Hollis
Assistant Secretary